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TAGS: ECON EFIN EINV MI
SUBJECT: IMF MALAWI REVIEW: ANOTHER GOOD QUARTER

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SUMMARY

¶1. (SBU) The IMF's country team today delivered its first quarterly review of Malawi's new Poverty Reduction and Growth Facility (PRGF). Malawi has met substantially all of its targets, although it appears headed to miss its net asset target next month. The IMF is recommending a looser foreign exchange policy to bring down the value of the kwacha and build foreign assets. Other economic measures are on track, most notably inflation and domestic debt, and the team expects to recommend HIPC completion by mid-2006. The team expressed concern that the GOM was being distracted by the volatile political situation here, a concern that we share. End summary.

HITTING THE TARGETS, BUT FOREX IS WORRISOME

¶2. (U) In a briefing on 21 November, the International Monetary Fund's country team reported another quarter of satisfactory progress on fiscal and monetary policy. The team said the GOM had met all quantitative targets, including ceilings on domestic debt and government wage expenses and a floor on net foreign assets. Nearly all structural targets were met, the exception being the establishment of a wage schedule for future government wage adjustments; IMF expects closure on this by end of year.

¶3. (U) The IMF's chief concern at this point is net foreign assets, which will likely miss the target in December and possibly for some brief period beyond. The team predictably attributed this problem to a combination of import pressures (mainly the result of high oil prices, but also increased food imports) and lower than projected forex earnings from this year's tobacco auctions (the result of poor quality harvests). An overly rigid foreign exchange policy, resulting in an overvalued kwacha, has exacerbated the

shortage of foreign currency. The team reports that it is working the GOM for a "prudent and flexible" exchange rate policy, which essentially means allowing the kwacha to continue to slip. (Note: The current black-market premium of about MK12-15/USD suggests that the kwacha should slip from MK121/USD to around MK133-136/USD, or 10-12 percent. End note.)

SOLID PROJECTIONS, AND LIKELY HIPC COMPLETION

¶4. (U) For the remainder of the fiscal year, the IMF team projects net domestic debt will stay below the 19.8 percent (of GDP) target, thanks mainly to the GOM agreeing to smaller increases in government wages. (If the GOM follows through on its proposed tax administration reforms, there is considerable room for improvement on the revenue side, which is not factored into current projections.) The team also sees inflation staying below its 16.7 percent target at fiscal year end (June). GDP growth is expected to rebound next year--an easy task following a drought year, provided there is not another drought.

¶5. (U) The IMF team expects to present a board recommendation for HIPC completion in May, with "one or two" waiver points, one of them almost certainly being the privatization of the state agricultural conglomerate Admarc. HIPC completion depends mainly on six months of satisfactory PRGF performance and the same period of satisfactory performance on the Poverty Reduction Strategy. The value of IMF debt service relief would be on the order of $12 million; the World Bank's debt service relief would jump from about $40 to $80 million.

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CONCERN OVER POLITICAL DISTRACTION

¶6. (SBU) In a side conversation following the briefing, several members of the team expressed concern over the political situation in Malawi. Their worries center on two points: the political gridlock that is preventing the government from getting even basic legislative action, and the growing distractions on finance minister Goodall Gondwe's attention. (Gondwe is standing for Parliament in the December 6 by-elections.) One member went so far as to say the Minister's attention to the IMF visit was markedly less than on previous visits; indeed, he missed the outbrief because of a campaigning commitment.

COMMENT: ONE LAST CHANCE AT REDEMPTION

¶7. (SBU) Overall, fiscal performance is the one bright spot on the Malawian political landscape. The IMF's resident representative regularly describes GOM performance as remarkable, an assessment with which we agree. Much of that performance has happened by the force of Gondwe's personality, and by his relative political neutrality (and, strangely, by the political neutrality of the budget issue in Malawi). But as the political opposition becomes more fractious, and as President Bingu wa Mutharika demands more political involvement from Gondwe, there is some danger that he will take his eye off the ball. While this looks unlikely at this point, it is cause enough for concern. One of the last remaining chances for Mutharika's political redemption is a strong economic recovery, which is still a real possibility. Gondwe has put the fundamental policies into place, and it is largely a matter of time before they produce

visible street-level results. In the meantime, though, he will have to pay attention and withstand growing pressure to fall back into the well-worn rut of fiscal mismanagement.
EASTHAM